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Testimony

Statement for the Record
Robert J. Lieberman
Deputy Inspector General
Department Defense
to the
Subcommittee on Readiness and
Management Support
Senate Armed Services Committee
on
Defense Financial Management

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Mr. Chairman and Members of the Committee:

Thank you for the opportunity to provide the views of the Office of the Inspector General, Department of Defense, on financial management, which surely ranks as one of the Department's most difficult management improvement challenges. I would like to begin with a brief recounting of recent audit results.

Opinions on Financial Statements for FY 2001

In terms of audit opinions on the reliability of DoD year-end financial statements, I am unable to report progress for the DoD-wide or major component funds. As in previous years, we issued an unqualified (clean) opinion for the Military Retirement Fund's statements. Disclaimers of opinion were necessary for all other major funds, however, because of serious deficiencies in the reporting systems and other internal control problems. A few DoD organizations, whose funds are not large enough to require separate reporting to OMB, have made progress, but the impact is primarily symbolic.

Measuring progress toward compliance with the Chief Financial Officers Act and related statutes has been extremely difficult, because the Government has lacked any metrics except audit opinions on year-end financial statements. I am greatly encouraged by the widespread support expressed for our concept of applying Year 2000 conversion-type metrics to the financial system improvement projects. As soon as the ongoing effort to develop a comprehensive systems architecture has laid the groundwork, we can begin assessing the progress of each system development or modification effort that is needed to achieve compliance with the new Federal Accounting Standards.

Other Recent Audit Results

Although the annual audit opinions may continue to attract more attention than most individual audit reports, the DoD progress in addressing the specific findings and recommendations in those reports will be a critical factor in how much financial management improvement actually occurs.

Now to bring the most important of these financial management audit findings to your attention. Their variety illustrates the breadth of the DoD financial management challenge.

-- We reported in March 2001 that the DoD Financial Management Improvement Plan, submitted to Congress in January 2001, was incomplete and did not ensure that the Department would correct financial system deficiencies and attain an integrated financial management system structure. In addition, the Plan erroneously indicated that 12 critical systems were compliant with Federal Financial Management Improvement Act requirements. The Plan was little more than a compilation of unvalidated inputs from various organizations. Its \$3.7 billion cost estimate for financial systems replacement or improvement was clearly understated and unreliable. (Report D-2001-085)

-- We reported in May 2001 that the Defense Finance and Accounting Service needed to be more efficient and aggressive in collecting debt from large contractors. We identified 148 cases worth \$12.6 million where action was needed. The List of Contractors Indebted to the United States, which is a tool used by disbursing officers to offset contractor debts, included numerous invalid debts and other erroneous data that reduced its usefulness. (Report D-2001-114)

-- In June 2001, we reported that DoD had successfully adapted a commercial automated payment system for DoD freight payment purposes. This enabled the Department to move away from untimely, paper-based, poorly controlled and labor intensive processes for 1.25 million payments per year. However, additional measures were warranted to take full advantage of the system's capabilities and achieve optimum streamlining without undue risk. (Report D-2001-148)

-- In August 2001, we reported that the DoD had failed to develop a standardized cost accounting system for managing the life cycle costs of weapon systems. DoD reports that various acquisition reform goals had been met by establishing such a system were wrong. (Report D-2001-164)

-- The DoD agreed with Congress in August 1998 to implement a new policy to decrease the risk of progress payments being charged to the wrong accounts. We reported in September 2001 that implementation had

been poorly managed and the new policy was ineffectual. (Report D-2001-188)

-- We reported in November 2001 that DoD financial management systems were not integrated and could not share data without expensive and inefficient crosswalks. Nevertheless, the Department had been moving ahead with the Defense Finance and Accounting Service Corporate Database and other projects with insufficient assurance that a truly integrated set of systems would result. (Report D-2002-014)

-- The DoD plans to transition from the existing contractor payment system, the archaic Mechanization of Contract Administration Services (MOCAS) system, to the new Defense Procurement Payment System by FY 2003. To ensure a smooth transition, it is important to close as many contracts that have been completed, but not closed out, as possible. In December 2001, we reported that DoD had a six year backlog of contract closure actions and needed to accelerate the process. In addition, there were weaknesses in the closure process itself, insufficient resources earmarked for the task and untimely contractor input. Cumulatively, these problems increased the risk to an orderly transition. (Report D-2002-027)

-- From FY 1996 through FY 2001, 382 General Accounting Office and DoD audit reports addressed a wide range of management control issues in the DoD Purchase Card Program. Those audit results were summarized in a December 2001 report. Auditors documented numerous instances of misuse of the cards, lack of oversight and accountability, splitting purchases to avoid oversight, failure to segregate duties and inadequate training. This program is beneficial, but will require continued oversight. (Report D-2002-029)

-- In January 2002, we reported that most DoD components had done little to implement the DoD Financial and Feeder Systems Compliance Process, which had been inaugurated in January 2001 to apply the proven management techniques of the Year 2000 conversion program to financial systems improvement. Progress in mapping the flow of financial data and compiling an inventory of systems had been disappointingly slow, despite the fact that such research was supposed to have been done earlier for a variety of reasons, including identification of security vulnerabilities, contingency planning, and systems architecture development. However, DoD management initiatives during FY 2001 and the guidance provided by

the National Defense Authorization Act for FY 2002 had established the groundwork for a more successful effort. (Report D-2002-044)

-- In March 2002, we reported that the two versions of the Computerized Accounts Payable System, used for Army and Defense agency payments, lacked effective controls to detect and correct improperly supported or erroneous payments to contractors. (Report D-2002-056)

The full text of our reports is available on-line at www.dodig.osd.mil.

Responding to Congressional Direction

Section 1008 of the National Defense Authorization Act for FY 2002 directs the Inspector General, DoD, to perform only the minimum audit procedures required by auditing standards for year-end financial statements that management acknowledges to be unreliable. The Act also directs us to redirect any audit resources freed up by that limitation to more useful audits, especially in the financial systems improvement area.

We strongly agree with the rationale behind Section 1008. Due to overall resource constraints, it would be impossible to provide audit support in the crucial systems improvement area if we were forced to expend resources on labor intensive efforts to audit the convoluted workarounds and poorly documented transactions that currently characterize most major DoD financial statements. We greatly appreciate your leadership in focusing attention on the system problems that are at the core of the DoD financial reporting problems. By rejecting the notion that financial statements compiled by special efforts, which bypass or override official accounting systems, are worth their high cost or constitute progress, you have reintroduced an appropriate sense of proportion.

DoD Initiatives

The initiatives announced by DoD over the past year appear to be highly compatible with the course mandated by Section 1008. For the past several years, we had expressed concerns that the cost of the Chief Financial Officers Act compliance effort was unknown, performance measures were lacking, there was no sense of consistently strong central leadership and there was no assurance that managers would get more useful financial

information, even if year-end financial statements eventually received favorable audit opinions.

We believe that the effort to establish a comprehensive financial system architecture is a necessary and long overdue step. There are undeniable risks--development of the architecture could take much longer than anticipated, the end product might leave numerous unresolved issues, the cost to implement the architecture might be prohibitively expensive or the DoD might lack the discipline to make system program managers conform to the architecture. Nevertheless, the financial management improvement effort needs to be treated as a program, with all of the management controls that a very large program should have. Those include a master plan, well defined management accountability, full visibility in the budget, regular performance reporting and robust audit coverage. We believe that the DoD is making a good faith effort to create a strong management structure for the systems improvement effort. We look forward to assisting with timely and useful audit advice, just as we did during the Year 2000 conversion.

Likewise, we welcome the emphasis in the President's Management Initiatives on controlling erroneous payments. The DoD has worked hard to improve the efficiency of its disbursement operations; however, this is another area where the inadequacy of current systems is the core problem. As the Department pursues the goal of greatly improved financial reporting, it must also keep focused on the need for better controls in many facets of its day-to-day finance operations. We understand the need for continuous audit coverage in that area too.

Again, thank you for soliciting our views on these matters.